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The Control of Capital Exports

A. Conditions under which capital exports would be restricted

The purpose of the International Stabilization Fund is to provide through stability of exchanges and through cooperation in the maintenance of exchanges, the conditions necessary for the restoration and balanced growth of international trade. In accordance with this purpose, it is not intended as a general policy to have the resources of the Fund used to finance an outflow of capital from member countries.

Just as the decade of the 1920's showed that few countries could withstand the internal drain on their gold and foreign exchange resources resulting from widespread conversion of local currency, so the decade of the 1930's showed that few countries could withstand the external drain on their gold and foreign exchange resources resulting from capital flight. Out of this experience has come general recognition that the gold and foreign exchange resources of a country should primarily be reserved for the settlement of international balances on current account. In line with this view, the general policy of the Fund should be to give countries access to the resources of the Fund only when such resources are needed to meet an adverse balance of payments on current accounts.

It would be quite incorrect to assume that most capital exports are prohibited by the Fund's rules or that the policy of the Fund with respect to capital exports requires the maintenance of exchange controls or exchange restrictions in all or even the majority of cases. It is recognized that there will be many countries in need of foreign capital for reconstruction and development after the war, and that there will be some countries whose international economic position will permit them to export capital.

The provision of capital under these conditions can contribute to the balanced growth of international trade. It should be noted that capital exports of this type are likely to be from countries with a credit balance of payments to countries with a debit balance of payments, and that they serve to maintain monetary stability. It is one of the purposes of the Fund to facilitate the resumption of such international lending.

A careful examination of the International Stabilization Fund proposal will reveal that most capital exports can probably take place freely and only in a minority of cases will exchange restrictions have to be imposed. The conditions under which capital exports may take place freely are described in the following paragraphs:

1. Capital exports of any type can take place freely from countries with a favorable balance on current account. The only exception to this might be the case where a country has been previously experiencing an unfavorable balance and has sold the Fund more of its currency than the Fund preferred to keep. In that event, the Fund might prefer to have the country employ part of its favorable balance of payments to purchase back some of the Fund's holdings of its currency before or pari passu with its undertaking significant amounts of capital exports.

2. Some countries with an unfavorable balance of payments could regard with complete equinimity an eflux of capital of any character because its holdings of foreign exchange and gold are entirely adequate to permit current drains. For example, the U.S. could permit very substantial and continuous capital exports for a long time even if its balance of payments turned unfavorable on current account. A number of countries could permit capital exports which for them would constitute only a moderate drain on their holdings.

3. All countries could permit capital exports which take the form wholly or chiefly of exports of goods or services even with a substantial lag. It has been a common practice in the past, and there is no reason to expect that it will cease completely in the future, for some foreign loans to be tied to exports in such a way that the granting of the loan is accompanied sooner or later by a net outflow of goods almost to the same magnitude of the loan.

Countries making loans to other countries with limited foreign exchange resources should be very reluctant to make loans in excess of the amount absolutely needed to purchase the additional imports effectuated directly or indirectly by the loan. The borrowing countries should be equally reluctant to burden their balance of payments unnecessarily by borrowing more for a particular project than is required to pay for the imports necessary to consummate that project making due allowance for secondary effects of the borrowing. No country should borrow abroad merely for the purposes of domestic financing.

4. Finally, even where a country has an unfavorable balance of payments and inadequate foreign exchange resources, the Fund would not be disturbed by capital exports from that country if the rate of export is small or if the Fund did not have large holdings of that currency or or if the capital exports were a sporadic or short time phenomena. It is only when the capital exports are (a) substantial and (b) sustained and are motivated chiefly by the desire for possible exchange gain or higher interest rates, greater security or the avoidance or evasion of high taxes that the Fund will require a restriction of capital exports as a condition for receiving aid from the Fund. But it is exactly loans of this character which should be restricted.

The flow of capital frim one country to another seeking political and economical security, or speculative profit is clearly undesirable. Such a flow is particularly disturbing because it is likely to be from countries with a debit balance of payments to countries with a credit balance of payments, and thus serves to disturb monetary stability. It is not the purpose of the Fund to acilitate such capital movements.

Until the Fund deems a continuation of capital exports of that character to be injurious, no restrictive action by the country in question over capital exports need be taken. It is only when the Fund refuses to continue to sell foreign exchange to the country in question that the latter must week ways of curtailing undesirable forms of capital exports. In some cases, it may be able to do so without the necessity of imposing exchange controls and restrictions. Where it cannot do so, short of imposing exchange restrictions, then the country will have to restrict the flow of capital through the exercise of carefully imposed exchange controls.

A proper evaluation of this aspect of the Fund's operations can be made only against the alternative. It would be quite erroneous to assume that in the absence of the Fund, countries could permit uncontrolled capital outflow of any character at all times. One needs only to point to the history of the last 20 years to make clear that controls over capital movements were adopted in a large number of countries even though no such institution as an International Stabilization Fund existed.

B. Techniques for the control of capital movements

The International Stabilization Fund proposal provides for the control of capital movements in two ways. First, member countries have the right to control capital exports, subject to the approval of the Fund, when such control is desirable from the standpoint of the general international economic situation. This control is strengthened by the fact that other member countries upon recommendation by the Fund have the duty of cooperating with member countries seeking to control capital exports, by refusing to permit capital imports from such countries and by other appropriate measures.

Second, under certain conditions described above the Fund itself may require that member countries control capital exports. It may be presumed that member countries will take the necessary steps, including in some instances supervision of the exchange market, to assure their capacity to fulfill the above obligations. The manner in which member countries organize and control their exchange markets is not prescribed by the Fund. Presumably, organization and control would differ from country to country depending upon the nature of its exchange market, the state of its monetary reserves, its balance of payments position, and the position of its currency in the Fund. Clearly in some countries no elaborate system of government organization and control of the exchange market will be necessary in order to assure fulfillment of its cooperative obligation to members of the Fund.

As a minimum, each country would certainly set up a system for collecting information on its balance of payments position and on capital movements. The receipt of such information would be vital to

the proper functioning of the Fund. Even though it never becomes necessary for a country to prevent a flight of capital, it may be necessary upon recommendation of the Fund to cooperate with other member countries in controlling capital movements. Such cooperative measures can appropriately include a refusal to accept or permit acquisition of deposits, securities or investments by nationals of any member country imposing restrictions on the export of capital except with the permission of the government of that country and the Fund. Member countries, on recommendation of the Fund, would also undertake to make available to the Fund or to the government of any member country full information on all property, deposits, securities and investments of the nationals of that member country.

To supply this current information, most countries will have to adopt at all times an adequate system of reporting capital movements. This is not to be confused with exchange controls. They are two quite separate things. The only countries that would have to adopt exchange controls are those whose foreign exchange resources do not permit a free and continued export of capital.

Some countries, foreseeing the need for control of capital movements, might require prior notification on international transactions in order to keep close control of its exchange position by scrutiny of such international transactions. Such scrutiny of exchange transactions would not be in conflict with the obligations of the member country unless if were used in fact as a device to impose exchange restrictions on current international transactions in the guise of a control of the export of capital. Since the imposition of restrictions on current

international transactions would be contrary to the obligations of a member country it may be presumed that the Fund would make representations to member countries if such scrutiny of exchange transactions were being used contrary to the purposes of the Fund.

Still other countries may find it desirable to set up a licensing system to assure an effective control over capital movements. Thus a country might require that all foreign exchange must be bought and sold through licensed dealers. No exchange would be sold unless the purchaser showed proof that the foreign exchange was needed for the purchase of goods and services or the payment of interest and dividends or other payments of a non-capital nature, and the delivery of foreign exchange receipts would be required of exporters and other recipients of funds from abroad. Banks and other institutions licensed to engage in foreign exchange operations might not be permitted to increase their foreign exchange holdings or holdings of other foreign assets beyond an amount necessary to carry on their normal business operations. The government might require that any additional amounts of foreign exchange acquired by dealers beyond the amounts necessary to meet the normal demands of their customers be turned over to the government.

It is not contemplated that control of international capital transactions or of exchange transactions generally will be exercised directly by the Fund. On the contrary, it is expected that the usual channels for buying and selling exchange will continue to be utilized and that the Fund will sell to member governments such foreign exchange as they may require to meet an adverse balance of payments on current account. The manner of channeling into the exchange market the foreign exchange sold

by the Fund is a matter for each member country to decide. While in the ordinary course of events the Fund would not scrutinize each exchange transaction, it may be expected that the Fund will require assurances in some instances that the exchange sold by the Fund is in fact needed exclusively to meet an adverse balance of payments on current account.

Our conclusions with respect to the control of capital movements may be summarized as follows:

1. All countries must have proper machinery for reporting capital movements by type and totals with geographical breakdowns.

2. A number of countries will find it necessary from time to time to maintain some form of exchange control.

3. Some of these countries will have to impose restrictions at one time or another on the outward movement of certain types of capital.

4. Under any circumstances the Fund does not of itself impose control over capital exports unless and until the member country is purchasing exchange from the Fund and then only if regarded appropriate to the general interest of the Fund and its members.

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